Supreme Court, U.S.
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No. 00 595

In the

Supreme Court of the United States

MAIER MCILNAY & KERKMAN, LTD.,

Petitioner,

versus

IRA BODENSTEIN, UNITED STATES TRUSTEE

and

MILWAUKEE ENGRAVING COMPANY, INC.

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED FOR REVIEW

In the situation where, at the time of filing a bankruptcy petition, a professional immediately files an application for employment by the debtor under 11 U.S.C. § 327, reasonably believes it will qualify for employment, and performs reasonable, necessary and beneficial services to the estate of the debtor prior to the hearing on the application, may the professional be compensated for those services under 11 U.S.C. § 503(b)(1)(A) if the application under 11 U.S.C. § 327 ultimately is denied?

RULE 29.6

Petitioner:	Maier McIlnay & Kerkman, Ltd. No publicly traded company owns 10% or more of the company's stock.
Respondent:	Ira Bodenstein, United States Trustee
Debtor:	Milwaukee Engraving Company, Inc. No publicly traded company owns 10% or more of the company's stock.

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In the Matter of: Milwaukee Engraving Company Incorporated, 219 F.3d 635, 36 Bankr. Ct. Dec. 107, (7th Cir. 2000)(Appendix 1a-8a); *In re: Milwaukee Engraving Co., Inc.*, 230 B.R. 370, 41 Collier Bankr. Cas. 779, (Bankr. E.D. Wis. 1998)(Appendix 9a-18a); *In re: Milwaukee Engraving Co., Inc.*, (E. D. Wis., August 25, 1999)(Unpublished)(Appendix 19a-30a)

STATEMENT OF BASIS FOR JURISDICTION

The decision sought to be reviewed issued by the Court of Appeals for the Seventh Circuit on July 16, 2000. No motion for rehearing was made. This court has jurisdiction to review this petition pursuant to 28 U.S.C. §§ 1254(1).

STATUTES INVOLVED

See Appendix

STATEMENT OF THE CASE

The underlying bankruptcy case was commenced by the filing of a Chapter 11 bankruptcy petition by the debtor, Milwaukee Engraving Company, Inc., on February 3, 1998. App. 10a. That same day, the debtor filed an application to employ Maier McIlnay & Kerkman, Ltd. ("MMK") as its general counsel. *Id.* The accompanying affidavit of Jerome R. Kerkman of MMK contained the disclosures required by 11 U.S.C. §§ 329 and 504 and Bankruptcy Rules 2014(a) and 2016(b). *Id.*

The Kerkman affidavit disclosed that MMK represented Black Hawk Label, Inc., which was a sister

corporation of the debtor, and which owed the debtor approximately $78,000. App. 10a. The affidavit disclosed that MMK's representation was limited to the sale of Black Hawk's assets to a third party "with the hope of obtaining some repayment on the debt owed the debtor." *Id.* Under an agreement between the debtor and Black Hawk, the debtor would receive the proceeds of the sale after payment to Black Hawk's other creditors and attorney fees. *Id.* The Kerkman affidavit disclosed that none of the creditors was represented by MMK. *Id.*

The United States Trustee opposed the application to employ MMK, arguing that MMK was not "disinterested" within the meaning of 11 U.S.C. § 101(14) and, therefore, could not represent the debtor under 11 U.S.C. § 327(a). *Id.*

There was no hearing on the motion to employ MMK until March 6, 1998. *Id.* The delay was not due to any neglect or oversight on the part of MMK, but "rather the demands of the [bankruptcy] court's calendar." App. 16a. During the period before the hearing, MMK provided services to the debtor including:

- advising the debtor on legal issues in operation of its business after it filed its Chapter 11 petition;
- negotiating and drafting a disclosure statement and plan of reorganization;
- appearing at hearings related to the confirmation of the plan;
- reviewing claims and demanding return of preferences;
- seeking approval of the debtor's cash collateral agreement;
- addressing adequate protection issues; and
- maintaining the debtor's utilities.

App. 16a-17a. As the Bankruptcy Court later found, the work performed by MMK was "critical to the successful reorganization of the debtor. App. 17a. The Court also found that those services "quite likely could not have been deferred without compromising the case." *Id.* Likewise, it found that the services were "reasonable, necessary and beneficial to the estate." App. 17a.

When the Bankruptcy Court ultimately held the March 6 hearing the application to employ MMK, it sustained the United States Trustee's objection. Determining that MMK would be obligated to scrutinize its own fees as counsel for the debtor to maximize the debtor's claim, the Court held that MMK could not represent both Black Hawk and the debtor. App. 10a-11a. As the bankruptcy court eventually found, however, "it was rational for MM&K to have no reason to believe that it would not qualify for employment." App. 17a. Once MMK knew that it was not to be employed, it "expeditiously sought alternative counsel for the debtor." *Id.*

MMK ultimately filed an application for compensation for services rendered to the debtor, contending that it could receive compensation under 11 U.S.C. § 503(b)(1)(A). App. 11a. In its fee application, MMK did not seek "compensation relating to its retention or for services provided during the transition of the case to replacement counsel." App. 17a. The application was opposed by the United States Trustee. App. 11a The Bankruptcy Court rejected the objection and granted MMK's motion. App. 17a.

The United States Trustee appealed the allowance of fees and expenses to the District Court, arguing that the allowance of fees and expenses was not permitted because MMK was disqualified from representing the debtor under § 327, and fees could be allowed under § 503(b)(1)(A) only if first approved under § 330. App. 24a. The United States Trustee also argued that the Bankruptcy Court had made

insufficient findings of fact. App. 29a. The District Court affirmed the Bankruptcy Court on both issues. App. 30a.

The United States Trustee then appealed to the Seventh Circuit Court of Appeals solely on the issue of whether fees could be allowed under § 503(b)(1)(A). The Court of Appeals reversed, holding that a professional such as MMK cannot receive compensation for services on behalf of a debtor unless the professional is employed under § 327(a). The decision is in direct conflict with a decision of the Sixth Circuit, *Federated Dept. Stores, Inc. v. Shearson Lehman, Inc., (In re Federated Dept. Stores, Inc.)*, 44 F.2d 1310 (6th Cir. 1995).

Jurisdiction of the bankruptcy court was proper pursuant to 28 U.S.C. § 157(b)(2)(A), (B) and (O) and 28 U.S.C. § 1334 and the general reference by the district court, under 28 U.S.C. § 157(a), to the bankruptcy judges of the Eastern District of Wisconsin of all proceedings arising in or relating to a case under Title 11. Jurisdiction of the district court was proper pursuant to 28 U.S.C. § 158(a)(1). The Court of Appeals had jurisdiction over the appeal pursuant to28 U.S.C. §§ 158(d) and 1291.

REASONS FOR GRANTING THE WRIT

The critical issue presented here is of vital importance not only to professional persons employed by debtors in bankruptcy cases under Chapter 11 of the United States Bankruptcy Code, but to the debtors who employ them. Under the decision of the Seventh Circuit, a professional who provides services to a debtor while the professional's application to be employed is pending must be denied all compensation if the bankruptcy court ultimately decides that the professional is not "disinterested." Because the term has an elastic meaning, a professional can never know that it will pass the test until a bankruptcy court actually finds that it is disinterested. The result is to encourage professionals not to provide services to a debtor until a bankruptcy court rules on

the employment application. Yet the time when the professional is cautioned not to provide services is when the debtor may need them the most – immediately after the filing of its bankruptcy petition. Failure to act during that time may doom to failure any chance the debtor has of reorganizing successfully.

The decision of the Seventh Circuit conflicts directly with a decision of the Sixth Circuit in *Federated Dept. Stores, Inc., supra*, which recognizes that there may well be times when a professional, not knowing that it is not authorized represent a debtor under § 327(a), provides beneficial services to the debtor. In such cases, as is the one here, according to the Sixth Circuit a court may apply equitable principles and allow compensation for the period of time before which the professional becomes aware of the disability.

Because there is no reasoned basis for the Seventh Circuit's decision, because the decision results in an irreconcilable tension between a debtor and its professionals in the critical first stages of a Chapter 11 reorganization, and because it conflicts with *Federated Dept. Stores*, review by this Court is warranted.

I. THE CONFLICT AMONG THE CIRCUITS IS AN IMPORTANT MATTER NEEDING RESOLUTION BY THIS COURT.

In this case, the Seventh Circuit decided that an absolute prerequisite to compensation of a professional which performs services for a Chapter 11 debtor is an order authorizing the employment under 11 U.S.C. § 327(a). Under the decision, a professional which has not obtained such an order may not be compensated no matter what contribution the professional makes to the debtor or the success of its reorganization. In contrast, the Sixth Circuit in *Federated Dept. Stores, supra,* recognized that in certain

circumstances equity demands that a professional which has provided valuable services, not knowing that it would be ineligible for employment under § 327, may be compensated for those services. The decisions of the two courts are directly conflicting. As petitioner will show below, if the Seventh Circuit decision is permitted to stand, it will have a material, adverse impact on the bankruptcy system.

A review of the *Federated Dept. Stores* decision brings into focus its conflict with *Milwaukee Engraving*.

In January 1990, Federated Department Stores, Inc. filed for bankruptcy protection and sought bankruptcy court approval to retain Shearson Lehman, Inc. as its investment advisor.[1] The employment was opposed by the United States Trustee who argued, accurately, that Lehman Brothers was not a "disinterested person" and thus could not be employed under § 327. The bankruptcy court, however, approved the employment under an erroneous interpretation of the statute. That decision was upheld by the district court.

While the Federated bankruptcy was proceeding and Lehman Brothers was providing services, the Sixth Circuit decided another case, *In re Middleton Arms Ltd. Partnership*, 934 F.2d 723 (6th Cir. 1991), which held that an interpretation of § 327 similar to that adopted by the Federated bankruptcy court was legally incorrect. Lehman continued to provide services.

In April 1992, Lehman Brothers sought compensation for its services. The bankruptcy court allowed the compensation over the objection of the United States Trustee. The district court again affirmed. The Sixth Circuit then reversed in part.

In its decision, after discussing the application of *Middleton Arms*, the court held that, because Lehman Brothers had never been a "disinterested person," it never had

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[1] The name was changed to Lehman Brothers during the pendency of the case. 44 F.3d at 1312, n. 1. Petitioner will use the designation of "Lehman Brothers," as did the court.

been employed under § 327(a). 44 F.3d at 1319 ("We have already decided that Lehman Brothers' appointment was invalid and, therefore, Lehman Brothers was not a person employed under § 327(a)"). The court then held that Lehman Brothers was not entitled to compensation under § 330(a) because appointment under § 327(a) is a requirement for compensation under that statute. *Id.* at 1320.

Although the court held that Lehman Brothers could not qualify for compensation under § 330, it did not withhold all compensation. Rather, it looked to equitable considerations in allowing compensation for services rendered until the time the court issued it *Middleton Arms* decision. The court explained:

> Despite our holding today, we believe denying all compensation to Lehman Brothers would not be equitable. Neither *Middleton Arms* nor *Eagle-Picher* involved our directing a debtor's financial advisor to disgorge fees which had already been distributed to those entities. It is conceded that Lehman Brothers rendered valuable services to Federated during the reorganization. Until *Middleton Arms* was decided, there was no definitive appellate court decision which has come to our attention that determined the question of Lehman Brothers' qualifications to serve as Federated's financial advisor despite its interested status.
>
> Under these peculiar and unique circumstances, which are not likely to be repeated again in light of the now settled law in this circuit, we are of the view that fairness and equity dictate allowing Lehman Brothers to be compensated at its agreed rate up to June 6, 1991, but not beyond. Any fees and costs allowed and paid to Lehman Brothers in this case after June 6, 1991, will be promptly

> refunded to the bankrupt debtor. After that date on which Middleton Arms was decided, Lehman Brothers is charged with the knowledge that it was proceeding at risk and beyond the equitable authority of the bankruptcy court to effect further compensation.

44 F.3d at 1320 (Footnote omitted).[2]

Thus, the Sixth Circuit permits compensation of a professional which is not a "disinterested person," and which has not been employed under § 327(a), in a situation where the professional has not been "charged with knowledge" of its disability but has provided valuable services to a debtor in its reorganization efforts. The equitable principles recognized by the court, which trump § 327(a), are two-fold: lack of knowledge of the fact that the professional would be disqualified from employment, and the provision of valuable services during that time.

In contradistinction, however, the court in Milwaukee Engraving adopted a blanket rule: the Bankruptcy Code does not permit compensation to a professional if its employment has not been approved under § 327(a). Contrary to the Sixth Circuit, the Milwaukee Engraving rule denies a bankruptcy court any discretion to apply equitable considerations.

The effect of the varying interpretations of the Bankruptcy Code has manifest impact in a case such as the present. Under the Seventh Circuit rule, simply because MMK was not employed under § 327(a), it could not receive compensation, despite having provided necessary and beneficial services to the debtor while awaiting the

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[2] The court's reference to *Eagle-Picher* is *In re Eagle-Picher Industries, Inc.*, 999 F.2d 969 (6th Cir. 1993), which reaffirmed *Middleton Arms*.

bankruptcy court's hearing on the pending employment application.

However, under the Sixth Circuit interpretation, the bankruptcy court properly could have applied equitable principles to determine (as it did) that, although MMK was not "disinterested," it could be allowed compensation where:

1. MMK had no reason to believe it would not qualify for employment (as, in *Federated*, the professional was not charged with knowledge until the court decided *Middleton Arms*);

2. The services provided by MMK were reasonable, necessary and beneficial to the estate (in *Federated* Lehman Brothers "provided valuable services"); and

3. The delay in determining the question of disinterestedness was not occasioned by MMK (in *Federated*, Lehman was allowed compensation until the time the court of appeals ruled on the proper interpretation of § 327).

At bottom, the Sixth Circuit holds that equitable considerations may allow compensation to a professional even when the professional is not employed under § 327(a). The Seventh Circuit, in contrast, finds employment authorized under § 327(a) an inflexible condition to compensation regardless of equitable principles. The two interpretations of the Bankruptcy Code are directly at odds. Either compliance with § 327(a) is – or is not – an absolute

requirement for allowance of compensation to a professional employed by a debtor. This Court ought properly resolve the issue.

II. THERE IS NO REASONED BASIS FOR THE SEVENTH CIRCUIT'S INTERPRETATION OF THE RELEVANT

In *Milwaukee Engraving*, the Seventh Circuit gave no reasoned analysis for its interpretation of the Bankruptcy Code. Rather, the full substance of the court's reasoning is contained in one paragraph:

> *Singson* disposes of the question at hand. True, the facts of *Singson* differ from the facts of this case, but the legal issue is the same: may a bankruptcy court compensate an attorney for services despite denying an application under § 327? That issue was resolved in *Singson*, which answered "no." *Singson* concluded that it would vitiate the limitations of §327 if a bankruptcy court could deny an application under that section and order the estate to pay for the legal services anyway. Moreover, the structure of § 503(b) strongly implies that professionals eligible for compensation must receive it under § 503(b)(2)--which depends on authorization under § 330 or § 1103(a) (and thus on approval under § 327). One might as well erase § 503(b)(2) from the statute if attorneys may stake their claims under § 503(b)(1)(A) even when ineligible under §§ 327, 330, and 503(b)(2). Our opinion in *Singson* did not spell this out at length, but there was no need to do so, for the subject had been covered by another circuit, whose conclusion we

> endorsed. See *In re F/S Airlease II, Inc.*, 844 F.2d 99, 108-09 (3d Cir. 1988), cited with approval in *Singson*, 41 F.3d at 320. Appellate opinions need not rehash settled law to enjoy respect by district courts. Brevity in stating a holding is a virtue, and a decision's central conclusion is no less a "holding" for being succinct.

App. 4a.[3] 41 F.3d at 320.

In sum, the court's reasoning jumps from the observation that the structure of § 503(b) "strongly suggests" that a professional must seek compensation under § 503 (b)(2) to a conclusion that allowing attorneys compensation under § 503(b)(1) "might as well erase § 503(b)(2)." No further analysis is given explaining the court's conclusion. However, acknowledging that its previous decision in Singson used to reach this result did not spell out the

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[3] In *Matter of Singson*, 41 F.3d 316 (7th Cir. 1994), the court determined that a professional which performed services beyond those authorized by its appointment could not seek retroactive approval, and could not use § 503 to recover its fees, when the bankruptcy court found the work noncompensable. The court stated:

> Our conclusion that the bankruptcy judge acted within his discretion in denying the application for retroactive approval disposes of any claim under 11 U.S.C. § 503. That section provides for priority payment of administrative expenses, but legal (and other professional) fees during the administration of the estate become administrative expenses only to the extent they are approved under § 327 or some other section, such as 11 U.S.C. § 330 or § 1103(a). Nothing in § 503 permits a law firm to recover fees for work that the bankruptcy judge has concluded is noncompensable.

Singson used to reach this result did not spell out the reasoning either, the court relied upon a single reference to a Third Circuit case, *In re F/S Airlease II, Inc.*, 844 F.2d 99 (3d Cir. 1998), to impliedly fill in the reasoning. *F/S*, however, does nothing to supplement the court's conclusion.

In *F/S*, a professional provided services to a debtor in possession but waited nearly a year to seek approval of its employment. When the bankruptcy court granted retroactive approval and then allowed the professional's fees, its decision was appealed.

On appeal, the primary issue was whether the bankruptcy court erred in allowing the retroactive approval. 844 F.2d at 105-108. The court indeed concluded it had. *Id.* at 108. The critical factor convincing the court that the retroactive approval was erroneous was that the professional was not "under such pressure to begin services that prior approval could not reasonably be sought." *Id.* at 106. In light of the long delay in seeking approval, it was an easy step to find the delay unreasonable. As the court noted, the professional "did not seek the requisite approval from the court when [the debtor's] bankruptcy began, nor did he seek approval at any time during the four-month period in which he was performing services." *Id.* at 107.

Only after the court had reversed on the retroactive approval did it turn to the professional's "additional considerations" which, as the court noted, had not even been reached below. *Id.* at 108, n. 10. One such other contention was that the professional could seek compensation under § 503(b)1)(A). The court's reasoning in denying the contention was a sparse as that of the Seventh Circuit here:

> The authority to pay administrative expenses for professionals, and a real estate broker, like an attorney, is a professional, is found not in section 503(b)(1)(A) but in section 503(b)(2) which permits payment as an administrative expense for "compensation

> 330(a)." Section 330(a), in turn, empowers the court to award "reasonable compensation" to, inter alia, a "professional person employed under section 327." Because Simon is a professional person who was hired to "assist the [debtor-in-possession] in carrying out the [debtor-n-possession's] duties," see §11 U.S.C. 327(a), and he failed to comply with that section's requirement to obtain prior approval of his appointment, he cannot rely on section 503(b)(1)(A) as a way of circumventing section 327(a). *See In re Mansfield Tire & Rubber Co.*, 65 B.R. 446, 465-6 (Bankr.N.D.Ohio 1986). If Simon were able to be compensated under section 503(b)(1)(A), it would render section 327(a) nugatory and would contravene Congress' intent in providing for prior approval.

Id. at 108-109 (Footnote omitted).

The court's reasoning adds nothing to the Seventh Circuit's truncated analysis. The court merely concluded that, since § 503(b)(2) allows administrative expense status for professionals employed under § 330(a), which in turn allows an award for a professional employed under § 327, a professional employed by a debtor in possession who does not obtain "prior approval of his appointment" cannot rely on § 503(b)(1)(A). Without even suggesting how it might occur, the court stated baldly that allowing compensation to a professional under § 503(b)(1)(A) would render § 327 nugatory and contravene Congressional intent.

As is obvious from the court's decision in *F/S*, there was no textual analysis of the sections of the Bankruptcy Code being considered. Rather, relying solely upon a district court decision, the court reached an unsupported result. Its conclusion, in turn, is the support for the Seventh Circuit's rationale that allowing a professional to be awarded

rationale that allowing a professional to be awarded compensation under § 503(b)(1)(A) would "erase" § 503(b)(2).

However, when even a minimal analysis of the relevant statutes is undertaken, it becomes obvious that there is nothing underpinning the court's conclusion. Indeed, allowing a professional to seek compensation under § 503(b)(1)(A) – particularly in a situation where the professional seeks approval of its employment at the first possible instance, but a bankruptcy court delays ruling on the application while the professional provides critical services to the debtor – is perfectly consistent if the services provided by the professional are in fact beneficial to the debtor's estate.

III. ALLOWANCE OF COMPENSATION UNDER § 503(b)(1)(A) DOES NOT AFFECT THE OPERATION OF § 503(b)(2).

Under the Bankruptcy Code, there are multiple provisions under which a bankruptcy court may award fees and expenses to an entity which provides goods or services to a bankruptcy estate. One such provision is § 330(a), which provides that a bankruptcy court may award reasonable fees to a professional employed pursuant to court order under § 327.

In order to qualify for employment under § 327, and thus the "reasonable" compensation provision of § 330, a professional must not hold or represent an interest adverse to the bankruptcy estate and must be a "disinterested person." *See*, 11 U.S.C. §§ 327(a) and 101(14). If the professional meets both qualifications, and is employed by the debtor under § 327, its fees and expenses do not have to provide tangible benefit to the bankruptcy estate in order to be entitled to compensation; it is only necessary that they be incurred by the professional reasonably and consistent with its duties to the estate. *In re Taxman Clothing Company*, 49 F.3d 310, 313 (7th Cir. 1995). Thus, for example, if an

bankruptcy estate but is "unlucky" and loses, he will still have a good claim for his fees under § 330. *Id.*

In contradistinction to § 330, under § 503(b)(1)(A) of the Bankruptcy Code an entity which provides services to the debtor which are in fact "beneficial" and "necessary for a successful reorganization" is entitled to payment. *In re Jartran, Inc.*, 732 F.2d 584, 587-588 (7th Cir. 1984). However, unlike the situation under § 330, there is no statutory requirement that the entity receive approval of the bankruptcy court before providing the services. The "pre-qualification" requirement of § 330 is absent, but the standard of benefit which must be conferred upon the bankruptcy estate is elevated.

At bottom, under § 330, an entity which has been approved for employment under § 327 is entitled to receive compensation regardless of the benefits to the estate. Under § 503(b)(1)(A) however, there is no statutory need to comply with § 327, but compensation is limited to services which are both beneficial and necessary for a reorganization effort. The statutes complement each other.

The result reached by the Seventh Circuit, however, ignores the distinction between the burdens and benefits apportioned between the two provisions. The court does not address why, if a professional which is not employed under § 327 is allowed compensation for services which are actually necessary for the preservation of a debtor's estate, such a result would have any improper impact on § 503(b)(2). Nor does the court address the Congressional purpose of restricting compensation of professionals solely to ones employed under § 327(a). Indeed, in a situation such as this, where a professional sought approval of its employment at the first moment it could, but the bankruptcy court delayed in ruling upon the application while the professional rendered beneficial services to the debtor, allowance of reasonable compensation for those services has no effect on § 327(a) or § 503(b)(2).

The Seventh Circuit refused to recognize that allowance of compensation to a professional which has provided services which, in fact, are necessary to the preservation of the estate can be harmonized with allowance of fees to a professional, appointed under § 327(a), whose services no not have to benefit the estate. Rather, the Seventh Circuit rendered an interpretation of the Bankruptcy Code may impose a pernicious impact on Chapter 11 debtors.

IV. THE SEVENTH CIRCUIT DECISION PROMOTES UNREASONABLE PUBLIC POLICY.

Under *the Milwaukee Engraving* holding, counsel for a Chapter 11 debtor is placed in an untenable position and encouraged not to provide services for the debtor when those services are most necessary. Acceptance of the holding bodes ill for debtors and undermines Congressional policy of rehabilitating businesses.

When a Chapter 11 reorganization case is filed, the debtor often desperately needs immediate legal services. Delay can be fatal to any opportunity the debtor has of rehabilitating successfully.

For example, cash collateral agreements must be negotiated and approved lest a debtor, often in default to its secured creditors, effectively be prohibited from paying employees and suppliers of necessary goods and services. Action must be taken on leases and executory contracts. Utility service must be maintained. Often action must be taken immediately to prevent violations of the stay imposed by 11 U.S.C. § 362. New lines of credit may be required; these must be negotiated, documented, and presented to the bankruptcy court for approval. Failure by counsel for the debtor to act immediately may doom any chance the debtor has to emerge from a Chapter 11 intact.

The Milwaukee Engraving decision, however, counsels attorneys for a Chapter 11 debtor to do nothing until

a bankruptcy court rules on an application for employment. According to the Seventh Circuit, if the attorneys are later found not to be "disinterested" by the bankruptcy court, the attorneys are entitled to nothing, whatever the merits of the services rendered to the debtor. This is exacerbated by the lack of any concrete definition of "disinterested" in the Bankruptcy Code, and practically compels attorneys to do as little as possible for a debtor until the bankruptcy court rules on the employment application.

As explained in *In re Martin*, 817 F.2d 175, 181 (1st Cir. 1987), the Bankruptcy Code "is less than explicit in mapping the contours of the disinterestedness requirement. Although it is easy to spot situations which fall at either end of the spectrum, . . . there is a scumbled area in the middle where cannot be easily color-coded." In light of the "scumbled area" in the midst of the disinterestedness forest, *Milwaukee Engraving* by its very terms dictates to bankruptcy attorneys, who lack prescience, to do little for a debtor-client until a bankruptcy court rules that they are approved for employment by the debtor. It cautions that they should not invest substantial time in a Chapter 11 case until that ruling is made. That bankruptcy court ruling, as in this case, may not come for a long time, during which the debtor is in need of immediate, critical services.

Milwaukee Engraving thus encourages counsel for a chapter 11 debtor to do nothing until actually approved by a bankruptcy court for employment. Indeed, *Milwaukee Engraving* goes so far as to state that, where the bankruptcy court ultimately denies the application for employment, counsel will have been "*forbidden* to represent the debtor." App. 5a (Emphasis in original). That determination, of necessity made on a retroactive basis, means that counsel's financial interest in doing nothing (lest it be merely volunteering its services) conflicts directly with a debtor's need for legal services long before a bankruptcy court rules on the application to employ the attorney. Thus, *Milwaukee Engraving* promotes conflict between a Chapter 11 debtor

and its counsel at the time when the debtor is at its most vulnerable. This results solely from the court's superficial review of the Bankruptcy Code, devoid of any consideration of those results, and creates an irreparable tension between attorney and client.

Perhaps realizing such an unacceptable situation, Judge Posner, writing for the panel in an earlier decision, explained when addressing the issue:

> It is a much more orderly system in which the lawyer applies for approval before he starts running up a large bill. Orderliness may not be the highest value and there may be cases in which time is so short that the lawyer must start work before he can file the application--and perhaps some bankruptcy judges, unlike the one in this case, sit on such applications for a long time, which could create great awkwardness. *Perhaps in a case in which the lawyer filed his application as early as was practicable, could not defer performing critical legal work for the debtor, and had no reason to believe that his application would be turned down--but it was, much later--section 330 could be bent to allow compensation. Conceivably section 503 of the Bankruptcy Code, the general administrative-claims section, could be used as a safety valve to relieve the rigidity of section 330 in cases in which it would be highly inequitable to deny a lawyer all compensation for services that had conferred a benefit on the debtor's estate* . . ..

Matter of Grabill, 983 F.2d 773, 777 (7th Cir. 1993).

Judge Posner's statement in *Grabill* admittedly was dicta. However, it recognizes the appropriate safety valve

against a situation such as would be created by *Milwaukee Engraving*, where delay by a bankruptcy court in ruling upon an application to employ counsel mandates that counsel's financial self-interest will conflict with the client's needs for immediate legal services. It is, in any event, a proper interpretation of the Bankruptcy Code. It is consistent with the Sixth Circuit's decision in *Federated Dept. Stores, supra,* and acknowledges the "awkwardness" of the state of affairs mandated by *Milwaukee Engraving.*

The decision by the Seventh Circuit in *Milwaukee Engraving*, conflicting directly and immediately with the Sixth Circuit decision in *Federated Dept. Stores*, sets an absolute bar to compensation of a professional which has not been employed under 11 U.S.C. § 327(a). In doing so, it advises counsel for a Chapter 11 debtor not to do its most to assist the debtor during a critical phase of the bankruptcy case, but to abstain from providing necessary services until a bankruptcy court rules on its employment application. It promotes a public policy harmful not only to bankruptcy professionals but the debtors they serve. *Federated Dept. Stores*, on the other hand, recognizes that compensation may be allowed, despite a professional not being employed under § 327(a), based upon equitable considerations. In doing so, it recognizes, as did the court in *Grabill, supra*, that in some instances equity must be invoked to achieve socially beneficial results. It underscores why *Milwaukee Engraving* should be reversed.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

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(any footnotes trail end of each document)

No. 99-3738

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

In the Matter of: Milwaukee Engraving Company, Incorporated,
Debtor.

Appeal of: Ira Bodenstein, United States Trustee

May 16, 2000, Argued

July 13, 2000, Decided

COUNSEL:
For IRA BODENSTEIN, Trustee - Appellant: William Kanter, Daniel L. Kaplan, DEPARTMENT OF JUSTICE, Civil Division, Appellate Section, Washington, DC USA.

For MAIER, MCILNAY & KERKMAN, LIMITED, Appellee: Mark S. Schmitt, MILLER, SIMON & MAIER, Milwaukee, WI USA.

For MILWAUKEE ENGRAVING COMPANY, INCORPORATED, Debtor: Paul A. Lucey, GODFREY & KAHN, Milwaukee, WI USA.

JUDGES:
Before Easterbrook, Ripple, and Rovner, Circuit Judges.

OPINIONBY:
Easterbrook

OPINION:

Easterbrook, *Circuit Judge.* When Milwaukee Engraving Co. entered bankruptcy, it was represented by Maier McIlnay & Kerkman, Ltd. (MMK). Section 327(a) of the Bankruptcy Code, *11 U.S.C. § 327*(a), permits a trustee or debtor in possession to "employ one or more attorneys . . . that do not hold or represent an interest adverse to the estate, and that are disinterested persons". Milwaukee Engraving filed an application seeking to use MMK's services in the bankruptcy proceeding. An accompanying affidavit asserted that MMK was disinterested but revealed that MMK represented Black Hawk Label, Inc., which owed Milwaukee Engraving some $ 78,000. This would not have been an interest "adverse to the estate" if Black Hawk had been flourishing, but it was not. Black Hawk (under joint ownership with Milwaukee Engraving) was arranging to liquidate. MMK represented Black Hawk in that endeavor and had first dibs on the proceeds of any sale, before the balance was distributed to Milwaukee Engraving and Black Hawk's other creditors. The United States Trustee objected to MMK's employment, and the bankruptcy court concluded that the law firm's interest in the proceeds from the sale of Black Hawk's assets meant that MMK represented an interest adverse to Milwaukee Engraving. See *11 U.S.C. § 101*(14)(E). Milwaukee Engraving acquiesced and engaged another law firm.

Section 330(a)(1)(A) of the Code conditions payment of "reasonable compensation for actual, necessary services rendered by . . . [an] attorney and by any paraprofessional person employed by any such person" on approval under § 327, which MMK lacked. Nonetheless, MMK asked the bankruptcy judge to approve payment of some $ 15,000 for the professional services it had rendered to Milwaukee Engraving between the commencement of the case and the approval of its replacement, about 20 days after the judge concluded that MMK was not disinterested. Bankruptcy

Judge McGarity granted this application, *230 B.R. 370 (Bankr. E.D. Wis. 1998),* relying on *11 U.S.C. § 503*(b)(1)(A), which permits the court to award as administrative expenses "the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case". The bankruptcy judge noted that MMK provided legal services for a month between filing and the decision under § 327, observed that these services were beneficial to the estate despite MMK's interest in Black Hawk, and concluded that it would be inequitable to deny MMK compensation. She recognized, however, that payment for legal services usually depends on § § 327 and 330, and that § 503(b)(2) grants administrative priority to "compensation and reimbursement awarded under section 330(a) of this title". By making express provision for employment under § 327, payment under § 330, and priority under § 503(b)(2), the Code logically forecloses the possibility of treating § 503(b)(1)(A) as authority to pay (and give priority to) claims that do not meet its substantive requirements. Statutes directly addressing a subject prevail over silences and implications of other provisions. We so held, for § § 327, 330, and 503 in particular, in *In re Singson, 41 F.3d 316, 320 (7th Cir. 1994),* and the bankruptcy judge acknowledged that the language of *Singson* bars an award to MMK.

Nonetheless, she stated, *Singson* must be read together with *In re Grabill Corp., 983 F.2d 773, 777 (7th Cir. 1993),* which raised the possibility that § 503(b)(1)(A) might provide independent authority to compensate attorneys. *Grabill* added that the sort of claim MMK makes--a request for compensation by a firm disqualified by interest--would not qualify under any approach, *983 F.2d at 777* ("The scattered cases, none at the court of appeals level, that allow a lawyer to be compensated who, lacking the requisite disinterest, could not have been appointed seem to us just

plain wrong."), but the bankruptcy judge thought that the "equities" of this case justified disregarding this observation. The district judge affirmed, concluding that for two reasons he need not follow *Singson*. First, the judge stated, *Singson* "made no mention of *Grabill* in its discussion of § 503." Second, *Singson* involved an untimely request for approval, while MMK sought approval at the outset of the case and bore the effects of congestion in the bankruptcy court's calendar.

Singson disposes of the question at hand. True, the facts of *Singson* differ from the facts of this case, but the legal issue is the same: may a bankruptcy court compensate an attorney for services despite denying an application under § 327? That issue was resolved in *Singson*, which answered "no." *Singson* concluded that it would vitiate the limitations of § 327 if a bankruptcy court could deny an application under that section and order the estate to pay for the legal services anyway. Moreover, the structure of § 503(b) strongly implies that professionals eligible for compensation must receive it under § 503(b)(2)--which depends on authorization under § 330 or § 1103(a) (and thus on approval under § 327). One might as well erase § 503(b)(2) from the statute if attorneys may stake their claims under § 503(b)(1)(A) even when ineligible under § § 327, 330, and 503(b)(2). Our opinion in *Singson* did not spell this out at length, but there was no need to do so, for the subject had been covered by another circuit, whose conclusion we endorsed. See *In re F/S Airlease II, Inc., 844 F.2d 99, 108-09 (3d Cir. 1988)*, cited with approval in *Singson, 41 F.3d at 320*. Appellate opinions need not rehash settled law to enjoy respect by district courts. Brevity in stating a holding is a virtue, and a decision's central conclusion is no less a "holding" for being succinct.

Although the bankruptcy judge believed that applying the Code literally would be inequitable, "bankruptcy courts are not authorized in the name of equity to make wholesale

substitution of underlying law . . . but are limited to what the Bankruptcy Code itself provides." *Raleigh v. Illinois Department of Revenue, 120 S. Ct. 1951, 1957, 147 L. Ed. 2d 13 (2000).* To the extent equity matters, the claim here is weaker than the one rejected in *Singson,* for in *Singson* the obstacle to payment was delay in submitting an application for approval. We held that only "excusable neglect" justifies failure to present an application for approval before performing legal services. We concluded that the law firm in *Singson* had not established "excusable neglect" and therefore could not receive approval under § 327. (It was this conclusion that made it necessary to decide whether the firm could be paid anyway under § 503(b)(1).) A timely application in *Singson* likely would have been approved. Here, by contrast, MMK is *forbidden* to represent the debtor. Using § 503(b)(1)(A) even to overcome a procedural glitch was disapproved by *Singson;* that holding logically entails the impropriety of using § 503(b)(1)(A) to defeat the principal function of § 327 by requiring the estate to compensate a law firm that labored under a conflict of interest.

The district judge believed that *Singson* need not be followed because the portion of the opinion dealing with § 503(b)(1)(A) did not discuss *Grabill.* This seriously misunderstands the relation between holding *(Singson)* and dictum *(Grabill).* A court need not rehash all prior mentions of a topic. What the panel said in *Grabill* was:

> It is a much more orderly system in which the lawyer applies for approval before he starts running up a large bill. Orderliness may not be the highest value and there may be cases in which time is so short that the lawyer must start work before he can file the application--and perhaps some bankruptcy judges, unlike the one in this case, sit on such applications

for a long time, which could create great awkwardness. Perhaps in a case in which the lawyer filed his application as early as was practicable, could not defer performing critical legal work for the debtor, and had no reason to believe that his application would be turned down--but it was, much later--section 330 could be bent to allow compensation. Conceivably section 503 of the Bankruptcy Code, the general administrative-claims section, could be used as a safety valve to relieve the rigidity of section 330 in cases in which it would be highly inequitable to deny a lawyer all compensation for services that had conferred a benefit on the debtor's estate and hence on the unsecured creditors seeking to deny him that compensation. Section 503(b)(1)(A), the only possibly relevant subsection, authorizes payment of the actual, necessary costs of preserving the estate. This subsection might, in the context of a Chapter 11 proceeding such as this, authorize the payment of a claim that arose from a transaction with the debtor in possession (that is, a transaction *after* bankruptcy has been declared) and was beneficial to the debtor in possession. *In re Jartran, Inc., 732 F.2d 584, 586 (7th Cir. 1984);* see also *In re Hemingway Transport, Inc., 954 F.2d 1, 5-7 (1st Cir. 1992).* (We don't suppose it matters whether the transaction is with someone who had rendered similar services to the debtor before bankruptcy.) We need not decide whether this provision can be invoked by a lawyer who renders postpetition services to the debtor that are not authorized by section 330, or whether the regime created by 330 is exclusive so far

> as lawyers' services to the debtor is concerned. [The law firm involved in this case] does not cite section 503.

983 F.2d at 777 (emphasis in original). This invited parties to later cases to investigate and brief the question, as the parties to *Grabill* had not. When *Singson* arose more than a year later, the parties *did* investigate and brief it. What they discovered--what the panel in *Grabill* had not known, given the absence of adversarial presentation--was that the question had been answered in other circuits. It was unnecessary for *Singson* to discuss *Grabill's* ruminations. That catalyst had its desired effect, the question was briefed, and *Singson* was the result. We cover *Grabill* now only to avoid the risk that courts will ignore *this* decision, just as the bankruptcy and district judges here decided that they need not follow *Singson,* but by doing this we do not mean to encourage lengthy explorations of dictum.

Just as *Grabill* is irrelevant to the authoritative status of the later decision in *Singson,* so *In re Crivello, 134 F.3d 831 (7th Cir. 1998),* another case the bankruptcy judge mentioned, is beside the point. A law firm received approval under § 327 and performed services, but it later came to light that the firm had prior connections with the debtor and related parties, plus prepetition claims against the debtor for legal work. Section 328(c) provides that a court "may deny allowance of compensation for services and reimbursement of expenses of a professional person employed under section 327 or 1103 of this title if, at any time during such professional person's employment under section 327 or 1103 of this title, such professional person is not a disinterested person, or represents or holds an interest adverse to the interest of the estate with respect to the matter on which such professional person is employed." The legal dispute in *Crivello* was whether § 328(c) requires the bankruptcy **[*639]** court to disallow *all* compensation for legal work

done. Emphasizing the word "may" in § 328(c), we held that a bankruptcy court has discretion to allow some compensation for work by a professional who was actually, but improperly, engaged under § 327. See *134 F.3d at 836-39.* MMK contends that if the law firm in *Crivello* could receive payment despite a lack of disinterest, it should be paid too; any other approach would create an incentive to lie (or shade the truth) in the initial application for employment. That is worrisome--though the professional consequences of deceit are not limited to a reduction of fees in a single case, so *Crivello* is unlikely to lead to fraud in order to get around *Singson.* But whatever arguments one may make as a matter of first principles, there is a dispositive difference under the statute Congress actually enacted. *Crivello* dealt with a firm whose employment had been approved under § 327(a), and whose compensation then was curtailed under § 328(c). Section 330 expressly permits payment in such cases, and § 503(b)(2) gives that debt administrative priority. MMK's application under § 327(a) was denied, so neither § 330 nor § 503(b)(2) assists it.

Only one possibility remains to be considered. Should we overrule *Singson?* MMK does not ask us to take this step; its submission rests on the proposition that *Singson* should be ignored because it did not "overrule" *Grabill.* (How *can* speculation be overruled?) At all events, it would not be appropriate to change our view of the relation among § § 327, 330, and 503(b). All other appellate decisions on the subject come out the way *Singson* did. See *In re Keren Limited Partnership, 189 F.3d 86, 88 (2d Cir. 1999); In re F/S Airlease II, supra.* Bankruptcy appellate panels in two additional circuits have reached the same conclusion. *In re Monument Auto Detail, Inc., 226 B.R. 219 (9th Cir. B.A.P. 1998); In re Albrecht, 245 B.R. 666 (10th Cir. B.A.P. 2000).* Accord, 6 *Collier on Bankruptcy* § 943.03[3][b][i] (15th ed., rev. 2000).

Reversed

Case No. 98-21027, Chapter 11

UNITED STATES BANKRUPTCY COURT FOR THE EASTERN DISTRICT OF WISCONSIN

In re: MILWAUKEE ENGRAVING CO., INC., Debtor.

June 30, 1998, Decided
June 30, 1998, Filed

COUNSEL:
For Plaintiff or Petitioner: Jerome R. Kerkman.

For Defendant or Respondent: David W. Asbach.

JUDGES:
Honorable Margaret Dee McGarity, United States Bankruptcy Judge.

OPINIONBY:
Margaret Dee McGarity

OPINION:

MEMORANDUM DECISION ON THE MOTION OF MAIER McILNAY & KERKMAN, LTD. FOR PAYMENT OF FEES, EXPENSES AND COSTS

The law firm of Maier McIlnay & Kerkman, Ltd., whose employment application was denied on the ground that it was not "disinterested" as required by *11 U.S.C. § 327*(a), sought approval of its fees and costs incurred in connection with this case. For the reasons stated below, its request is granted.

FACTS[1]

This case was commenced by the filing of a voluntary small business bankruptcy under chapter 11 on February 3, 1998. In addition to the petition and schedules, the debtor filed a proposed plan of reorganization, disclosure statement and request for conditional approval of the disclosure statement. On that same date, the debtor also filed an application to approve the retention of Maier McIlnay & Kerkman, Ltd., (MM&K) as its general bankruptcy counsel. [2] An affidavit of Attorney Jerome R. Kerkman contained the disclosures required by *11 U.S.C. § 329* and § 504, and Bankruptcy Rules 2014(a) and 2016(b).

The affidavit filed on February 3rd disclosed that MM&K also represented Black Hawk Label Co., Inc. Black Hawk was a sister corporation of the debtor, and both were owned and controlled by Dennis Dettmann, president of the debtor and Black Hawk. Black Hawk owed the debtor approximately $ 78,000. The affidavit disclosed that MM&K's representation was limited to the sale of Black Hawk's assets to a third party with the hope of obtaining some repayment on the debt owed the debtor.

The application to employ MM&K was opposed by the Office of the United States Trustee. The U.S. Trustee argued that the firm held an interest adverse to the estate and was not "disinterested" within the definition of that term in *11 U.S.C. § 101*(14) and thus was not qualified to be employed by the debtor under *11 U.S.C. § 327*(a).

At a hearing on March 6, 1998, this court sustained the U.S. Trustee's objection and denied the application to employ MM&K. The court determined that MM&K represented an interest adverse to the estate because the firm was to be paid from the proceeds of the sale of Black Hawk's assets. Under an agreement between the debtor and Black Hawk, the debtor would receive the proceeds of the sale after payment to Black Hawk's other creditors and attorney fees. As counsel for the debtor, MM&K would be obligated to scrutinize its own fees

to maximize the debtor's claim. Thus, MM&K could not represent both Black Hawk and the debtor.

This court also denied MM&K's motion to reconsider the denial of its application on March 16, 1998. No appeal has been taken from the court's decision denying approval of MM&K's employment.

Thereafter, the firm filed an application seeking compensation for services provided to and costs incurred for the debtor before the appointment of MM&K was denied. The application sought fees of $ 14,121.00 and costs of $ 442.13 for services provided and expenses incurred through March 25, 1998.

Maier McIlnay & Kerkman, Ltd.'s fee application was opposed by the U.S. Trustee on the ground that there is no legal basis for awarding attorneys' fees and costs to a law firm that has failed to qualify for employment by the debtor.

DISCUSSION

A chapter 11 debtor's counsel is normally awarded compensation under *11 U.S.C. § 330*(a). Section 330(a)(1) provides, in relevant part, that

> ... the court may award to ... a professional person employed under section 327 ...
>
> (A) reasonable compensation for actual, necessary services rendered by the ... professional person ...; and
>
> (B) reimbursement for actual, necessary expenses.

11 U.S.C. § 330(a)(1). Section 327(a), in turn, provides that

> ... the trustee,[3] with the court's approval, may employ one or more attorneys ... that do not hold or represent an interest adverse to the

> estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.

11 U.S.C. § 327(a).

Maier McIlnay & Kerkman does not contend that it may receive compensation under § 330(a), its employment not having been approved by the court under § 327(a). Instead, it asserts that its fees and costs should be allowed as actual, necessary costs of preserving the estate under *11 U.S.C. § 503*(b)(1). Section 503(b)(1) of the Bankruptcy Code provides that the court shall allow " ... the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case...." The firm contends that the services it provided to the debtor during the first two months of the case were actual and necessary and helped preserve the estate for the benefit of creditors.

Thus, the issue before the court is whether a law firm whose fees are not allowable under *11 U.S.C. § 330* because it does not qualify for employment under *11 U.S.C. § 327*(a) may have those fees allowed instead under *11 U.S.C. § 503*(b)(1).

The U.S. Trustee contends that professionals employed by the debtor-in-possession may only be allowed compensation as an administrative expense pursuant to § 503(b) if the requirements of § 327(a) and § 330(a) are met. The U.S. Trustee cites several Seventh Circuit cases for support, including *Matter of Grabill Corp., 983 F.2d 773, 777 (7th Cir. 1993), Matter of Singson, 41 F.3d 316, 320 (7th Cir. 1994),* and *In re Crivello, 134 F.3d 831, 840 n. 4 (7th Cir. 1998).* MM&K believes those cases are distinguishable on their facts.

Nothing in the plain language of § 503(b)(1) would appear to preclude an award of attorneys' fees and costs

actually and necessarily incurred by an attorney who was not and could not be employed by a debtor-in-possession or trustee. Thus, the court must look to case law for the answer.

The most recent Seventh Circuit decision regarding attorney compensation is *In re Crivello, 134 F.3d 831 (7th Cir. 1998)*. In *Crivello*, the law firm which represented the debtor-in-possession did not disclose prior connections it had with the debtor and related parties, as well as its prepetition claims against the debtor. The bankruptcy court and district court had denied all requested fees. The Seventh Circuit was faced with the issue of whether a bankruptcy court must deny fees when it subsequently learns that a professional never should have been employed under § 327(a) in the first place, or whether it has discretion to award or to deny fees. *Id. at 836.* The appellate court determined that a bankruptcy court has discretion under § 328(c) to award fees, in whole or in part, of an erroneously employed professional.

Unlike *Crivello*, the issue in this case involves the availability of compensation under § 503(b)(1), not § 327(a) and § 328(c). Also unlike the law firm in *Crivello*, MM&K's application for employment was never approved by the court due to its proper disclosure of its connections with parties related to the debtor. It would be odd, indeed, if a bankruptcy court were given discretion under the Bankruptcy Code to award compensation to a professional who was erroneously employed due to the professional's failure to disclose, yet precluded from awarding compensation to a professional who was never employed due to proper disclosure of the conflict. Such a rule would encourage nondisclosure of adverse interests, which most would agree would be highly undesirable policy.

In *Matter of Singson, 41 F.3d 316 (7th Cir. 1994)*, the law firm representing the chapter 7 trustee as special counsel sought compensation for services to the trustee that exceeded the scope of the court-approved limited purpose appointment.

The Seventh Circuit affirmed the bankruptcy court's decision that, although the law firm's time had been beneficial to the estate, compensation for any services beyond those authorized in advance were denied. The firm's request for retroactive approval of its employment for the unauthorized services was likewise denied.

The U.S. Trustee in this case contends that the following language in the *Singson* decision further precludes the approval of compensation for MM&K:

> Our conclusion that the bankruptcy judge acted within his discretion in denying the application for retroactive approval disposes of any claim under *11 U.S.C. § 503*. That section provides for priority payment of administrative expenses, but legal (and other professional) fees during the administration of the estate become administrative expenses only to the extent they are approved under § 327 or some other section, such as *11 U.S.C. § 330* or § 1103(a).
>
> Nothing in § 503 permits a law firm to recover fees for work that the bankruptcy judge has concluded is noncompensable.

Singson, 41 F.3d at 320 (citation omitted).

In essence, the court made quite clear that attorneys employed to perform one task cannot take it upon themselves to perform another. The *Singson* attorneys had a court order in place telling them what they could do, and they did something different. Taken alone, the quoted statement might support denial of MM&K's position, but it must be read in context with its facts and in conjunction with both *Crivello,*

supra, and *Matter of Grabill Corp., 983 F.2d 773 (7th Cir. 1993).*

In *Grabill,* the claimant applied for approval of its employment and was not approved for lack of disinterestedness. The debtor corporation retained the law firm prior to filing bankruptcy to help it restructure its unsecured loans. On the same day, the firm was also retained by the debtor's 100 percent owner. The firm ceased representing the owner after approximately two weeks, but the debtor's creditors filed an involuntary chapter 7 petition against the debtor two days later. The case was converted to a voluntary chapter 11, and the firm moved for approval of its employment of the debtor retroactively to the date of conversion. The bankruptcy judge denied the application because the firm was not "disinterested" due to its representation of the debtor's owner at a time when bankruptcy was known to be imminent.

After the bankruptcy judge denied its application for employment, the firm ceased to represent the debtor, but it continued to spend time and incur expenses in the bankruptcy proceeding. The bankruptcy judge denied the firm's application for reimbursement of services rendered during the eight months after its denial of employment. The court determined that compensation was only available to attorneys employed under § 327(a) to represent the debtor. The Seventh Circuit affirmed. The court noted that "the scattered cases, none at the court of appeals level, that allow a lawyer to be compensated who, lacking the requisite disinterest, could not have been appointed seem to us just plain wrong." *Grabill, 983 F.2d at 777.*

Notwithstanding this dicta, the court acknowledged the possibility of an award pursuant to § 503. Section 503 "could be used as a safety valve to relieve the rigidity of section 330 in cases in which it would be highly inequitable to deny a lawyer all compensation for services that had conferred a

benefit on the debtor's estate and hence on the unsecured creditors." *Id.* According to the *Grabill* court, to qualify for such an award, the claimant would have to seek approval of its employment as promptly as possible, perform critical services that could not be deferred, and have no reason to believe that it would not qualify for employment. *Id.* The court found the claimant in the case deficient in two respects: (1) not having applied for approval of its employment for nearly a month, and; (2) having known of the disqualifying factor from the beginning. *Id.* Also, substantial services were performed after denial of the application.

As far as this court can tell, the "safety valve" has not been closed shut by the subsequent Seventh Circuit rulings in *Singson* or *Crivello*. The courts were concerned that employed professionals take sufficient precautions to ensure that their services are within the scope of prior authorizations. *See Singson, 41 F.3d at 320.* This is the same concern articulated in *Grabill* -- that the claimant should seek approval of its employment as promptly as possible. Additionally, as noted by the *Crivello* decision, which was written after *Singson, "Grabill* remains authoritative for the issue of whether a professional may recover fees without prior approval from the bankruptcy court." *Crivello, 134 F.3d at 840 n. 4.*

Following *Grabill*, this court thinks it possible that an award based in equity could be made in an appropriate case, and this an appropriate case. MM&K certainly filed its application for employment promptly -- on the same date the petition was filed. Any delay in the denial of MM&K's application for employment was not due to the firm's neglect or oversight, but rather the demands of the court's calendar.

The services performed by MM&K included advising the debtor on legal issues involving the lawful operation of its business after it had filed a chapter 11 petition; negotiating and drafting a disclosure statement and plan; appearing at

hearings related to the confirmation of the plan; reviewing claims and demanding return of preferences; and seeking approval of the debtor's cash collateral agreement, addressing adequate protection issues and maintaining the debtor's utilities. MM&K is not seeking compensation relating to its retention or for services provided during the transition of the case to replacement counsel. The court has reviewed the time records of MM&K and finds that the work performed was critical to the successful reorganization of the debtor. This case was filed as a small business chapter 11 and consequently was put on a fast-track for confirmation. The services rendered by MM&K quite likely could not have been deferred without compromising the case. Once the firm knew it was not to be employed, it expeditiously sought alternative counsel for the debtor.

Finally, it was rational for MM&K to have no reason to believe that it would not qualify for employment. The disqualifying conflict was atypical. The firm did not represent competing interests, but rather shared a competing interest with the debtor itself. They had represented Black Hawk for a limited purpose, and that purpose in no way tainted the services performed for the debtor and for which compensation is requested. No conflict of interest arose until it came time to divide the proceeds of the Black Hawk sale, and at that point new counsel stepped in. The services provided by MM&K were reasonable, necessary and beneficial to the estate, *11 U.S.C. § 503*(b).

CONCLUSION

For the reasons discussed, the motion of Maier McIlnay & Kerkman, Ltd. for payment of fees, expenses and costs is granted.

Dated at Milwaukee, Wisconsin, June 30, 1998.

BY THE COURT:

Honorable Margaret Dee McGarity

United States Bankruptcy Judge

ORDER GRANTING THE MOTION OF MAIER McILNAY & KERKMAN, LTD. FOR PAYMENT OF FEES, EXPENSES AND COSTS

For the reasons set forth in the court's memorandum opinion entered on this date, IT IS ORDERED, the motion of Maier McIlnay & Kerkman, Ltd. for payment of fees of $ 14,121.00 and costs of $ 442.13 is granted.

Dated at Milwaukee, Wisconsin, June 30, 1998.

BY THE COURT:

Honorable Margaret Dee McGarity

United States Bankruptcy Judge

----------Footnotes----------

[1] Although the parties have not stipulated to the facts, none appear to be in dispute.

[2] The pleadings were filed on February 3 with the petition. For unknown reasons, they were held by the Bankruptcy Clerk's office and file-stamped on February 4, 1998.

[3] Section 1107(a) makes the term "trustee" synonymous with the term "debtor-in-possession" for purposes of this application.

Case No. 98-21027, Chapter 11

UNITED STATES BANKRUPTCY COURT FOR THE EASTERN DISTRICT OF WISCONSIN

In re: MILWAUKEE ENGRAVING CO., INC., Debtor.

August 26, 1999, Received
August 25, 1999, Filed

I. INTRODUCTION

Before the court is an appeal of a decision by the Bankruptcy Court for the Eastern District of Wisconsin. The United States Bankruptcy Trustee ("the Trustee") appeals a decision awarding the law firm of Maier, McIlnay & Kerkman, Ltd. ("MMK"), $14,563.13 in fees and costs incurred in representing Milwaukee Engraving, Inc. ("Milwaukee Engraving"), in a bankruptcy proceeding. This court has jurisdiction pursuant to 28 U.S.C. § 158(a)(1).

II. FACTUAL AND PROCEDURAL BACKROUND.

On February 3, 1998, Milwaukee Engraving Co., Inc. filed a voluntary petition for bankruptcy under Chapter 11 of the United States Bankruptcy Code. At that time Milwaukee stated that the company had an account receivable from Black Hawk Label, Inc. ("Black Hawk"), in the amount of $10,000. Counsel for Milwaukee Engraving and Black Hawk later stated that Black Hawk owed Milwaukee Engraving as much as $78,000. Black Hawk was owned entirely by Dennis Dettman, who also owned 55% of Milwaukee Engraving.

On the same day it filed its bankruptcy petition,

Milwaukee Engraving filed an application to employ MMK as its counsel. Along with the application, an attorney for MMK, Jerome Kerkman ("Attorney Kerkman") tiled an affidavit stating that MMK was also representing Black Hawk in that company's effort to sell all of its assets to a third party. Attorney Kerkman noted that Milwaukee Engraving was Black Hawk's largest unsecured creditor. Attorney Kerkman also stated that "[i]n assisting in the sale of the assets of [Black Hawk], [MMK] will endeavor to have paid to [Milwaukee Engraving] as much of the amount owed by [Black Hawk] to it as is available from the sale proceeds after the payment of secured or priority creditors, none of which are represented by [MMK]." (R.3¶4.c.)

On February 12, 1998, the U.S. Bankruptcy Trustee ("Trustee") filed an objection to the application to employ The Trustee argued that MMK's representation of Black Hawk made that law firm ineligible to represent Milwaukee Engraving's bankruptcy estate because Black Hawk's debt to Milwaukee Engraving created competing and adverse interests between the two entities.

On March 6, 1998, Judge Margaret Dee McGarity of this district's bankruptcy court sustained the Trustee's objection and denied the application to employ MMK. Judge McGarity found that MMK represented an adverse interest and therefore was not eligible for employment by Milwaukee Engraving's bankruptcy estate. The bankruptcy judge reasoned that because MMK's fees from Black Hawk would come from the sale of that company's assets, Milwaukee Engraving could have an interest in seeing those fees kept as low as possible. This could lead to a situation where MMK was required to scrutinize its own fees in order to properly represent Milwaukee Engraving's interests.

On March 12, 1998, MMK filed a motion asking the court to reconsider its decision. At a hearing on March 16,

1998, the court again heard arguments from MMK regarding the application for employment. Judge McGarity declined to reverse her decision, and reiterated her finding that MMK represented an interest adverse to Milwaukee Engraving's bankruptcy estate. On March 19, 1998, Milwaukee Engraving filed an application to employ a different law firm. The law firm of Godfrey & Kahn eventually replaced MMK as counsel for Milwaukee Engraving. The current dispute arises from the fact that MMK provided legal services to Milwaukee Engraving from the time Milwaukee Engraving filed its bankruptcy petition on February 3, 1998, until MMK turned the case over to Godfrey & Kahn on March 25, 1998.

On April 15, 1998, MMK filed a motion to recover the fees, expenses, and costs it had incurred during the time it represented Milwaukee Engraving. MMK sought these items as administrative expenses pursuant to 11 U.S.C. § 503(b)(1)(A). The total amount MMK sought was $14,121.00 in fees, and $442.13 in costs and expenses. On May 1, 1998, the Trustee filed an objection to MMK's motion. The Trustee argued that MMK could not recover administrative expenses under § 503(b)(1)(A) after having been found ineligible for employment because of its adverse interest. On June 8, 1998, the bankruptcy court heard arguments regarding MMK's motion.

On June 30, 1998, Judge McGarity issued an order allowing MMK to recover its fees and expenses in their entirety. The bankruptcy judge noted that MMK filed its application for employment as soon as possible—on the same day the bankruptcy petition was filed. The delay in the denial of MMK application was due to the court's calendar and thus beyond MMK's control. The court further explained:

> The services performed by [MMK] included advising the debtor on legal issues involving the lawful operation of its business after it had

> filed a chapter 11 petition; negotiating and drafting a disclosure statement and plan; appearing at hearings related to the confirmation of the plan; reviewing claims and demanding return of preferences; and seeking approval of the debtor's cash collateral agreement, addressing adequate protection issues and maintaining the debtor's utilities . . .. The court has reviewed the time records of [MMK] and finds that the work performed was critical to the successful reorganization of the debtor. This case was filed as a small business chapter 11 and consequently was put on a fast track for confirmation. The services rendered by [MMK] quite likely could not have been deferred without compromising the case.
>
> Finally, it was rational for [MMK] to have no reason to believe that it would not qualify for employment. The disqualifying conflict was atypical. The firm did not represent competing interests, but rather shared a competing interest with the debtor itself. They had represented Black Hawk for a limited purpose, and that purpose in no way tainted the services performed for the debtor and for which compensation is requested. No conflict of interest arose until it came time to divide the proceeds of the Black Hawk sale, and at that point new counsel stepped in.

(June 30, 1998 Mem. Dec. at 8-9.)

On July 10, 1998, the Trustee filed its notice of the current appeal.

III. ANALYSIS

This court reviews factual findings of the bankruptcy court under a clearly erroneous standard, and reviews its conclusions of law de novo. See In re Crivello, 134 F.3d 831, 835 (7th Cir. 1998),

A. Scope of 11 U.S.C. § 503

At issue in this appeal are two different procedures contained, in the Bankruptcy Code that permit persons employed in conjunction with a bankruptcy to be paid for their services and expenses. The first procedure is governed by 11 U.S.C. § 327 and 330(a). Section 330(a) permits the bankruptcy court to award an attorney compensation for services rendered and reimbursement for necessary expenses. In order to qualify for compensation pursuant to § 330(a), the attorney must have satisfied the requirements of § 327. Section 327 provides, in part:

> Employment of professional persons (a) . . . the trustee, with the court's approval, may employ one or more attorneys, accountants; appraisers; auctioneers, or other professional persons, that do nor hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.

(Emphasis added).

The second procedure at issue in this appeal is governed by 11 U.S.C. § 503. That section permits a bankruptcy court to award "administrative expenses" to persons employed by the bankruptcy estate. Section 503 provides:

> (a) An entity may timely file a request for

payment of an administrative expense.

> (b) After notice and a hearing, there shall be allowed, administrative expenses, including . . .
>
> (1)(A) the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case.

In her decisions below, Judge McGarity held that MMK's employment by Black Hawk gave it an interest adverse to Milwaukee Engraving and, thus, made MMX ineligible for employment as a professional person under § 327. As a result, MMK could not obtain compensation under § 330 for the work it had performed regarding Milwaukee Engraving's bankruptcy. Instead, Judge McGarity allowed MMK to receive that compensation pursuant to the "administrative expense" provisions of § 503(b)(1)(A).

The Trustee argues that the bankruptcy court's decision should be reversed. because sections 327 and 330 provide the exclusive mechanism for awarding fees and expenses to attorneys who perform work on behalf of the-bankruptcy estate. In the Trustee's view, permitting attorneys such as MMK to recover their fees and expenses under § 503 would undermine § 327's requirement that professional persons not hold an interest adverse to the estate. The Trustee also argues that even if the law permits recovery under § 503, the bankruptcy court failed to make adequate findings of fact to support its award to MMK.

The plain language of section 503(b)(1)(A) does not explicitly prohibit an award under the circumstances presented here. The statute itself is phrased very broadly; it

permits the recovery of "the actual, necessary costs and expenses of preserving the estate." 11 U.S.C. § 503(b)(l)(A).

Seventh Circuit case law regarding the scope of § 503 presents a mixed picture. Judge Posner speculated in In re: Grabill Corn., 983 F.2d 773 (7th Cir. 1993), that in certain limited circumstances § 503 might allow an award to firms in situations similar to MMK's. Grabill involved a law firm that had continued to perform work related to a bankruptcy proceeding after the bankruptcy court had ruled that the firm was not eligible for employment under § 327 because it represented an adverse interest. See id. at 774-75. The firm subsequently applied to the court for compensation under § 330 for the fees and expenses it accumulated both before and after its application for employment was denied. id at 775. The bankruptcy court denied the application.

The Seventh Circuit affirmed the decision, but in his opinion, Judge Posner discussed the possibility that §§~ 330 or 503 might permit an attorney to receive compensation despite having been disapproved under § 327. Judge Posner wrote:

> Perhaps in a case in which the lawyer filed his application as early as was practicable, could not defer performing critical legal work for the debtor, and had no reason to believe that his application would be turned down—but it was, much later—section 330 could be bent to allow compensation. Conceivably section 503 of the Bankruptcy Code, the general administrative-claims section, could be used as a safety valve to relieve the rigidity of section 330 in cases in which it would be highly inequitable to deny a lawyer all compensation for services that had conferred a benefit on the debtor's estate and hence on the

> unsecured creditors seeking to deny him that compensation. Section 503(b)(l)(A), the only possibly relevant subsection, . . . [might] authorize the payment of a claim that arose from a transaction with the debtor in possession and was beneficial to the debtor in possession

Id. at 777. The court was not required to decide that issue, however, because the law firm had not raised it. See id.

The Trustee argues that the Seventh Circuit later put an end to this issue in In re: Singson, 41 F.3d 316 (7th Cir. 1994). Singson involved a law firm that sought retroactive approval under § 327 for legal work already performed. id. at 318. The law firm had previously been approved to work on specific matters, but had then performed work outside the scope of that authorization. The bankruptcy court denied the request for retroactive authorization. The Seventh Circuit affirmed, noting that the firm had taken no precautions to ensure that it did not perform unauthorized work and that the firm had provided unnecessary services on some matters, at 320. Most significant for purposes of the present action, the Singson court commented on the scope of § 503. The court stated:

> Our conclusion that the bankruptcy judge acted within his discretion in denying the application for retroactive approval disposes of any claim under 11 U.S.C. § 503. That section provides for priority payment of administrative expenses, but legal fees during the administration of the estate become administrative expenses only to the extent they are approved under § 327 or some other section, such as 11 U.S.C. § 330 . Nothing in § 503 permits a law firm to recover fees for

> work that the bankruptcy judge has concluded is noncompensable.

(emphasis in original).

This court does not read Singson as being the last word on the scope of § 503. The Singson court made no mention of Grabill in its discussion of § 503. In addition, the facts of Singson distinguish it from the present case. The law firm in Singson had already received direction from the court regarding the scope of the work it could perform. In this case, MMK sought approval for its employment at the commencement of the bankruptcy, but was unable to obtain a ruling from the court until after it had performed significant amounts of work. As Judge McGarity noted, any delay in considering MMK's application was due to the constraints of the court's calendar, rather than neglect by MMK.

The Trustee's strongest argument is that permitting firms in MMK's situation to receive an award under § 503 would undermine the Bankruptcy Code's policy of ensuring that bankruptcy estates receive untainted advice from loyal and disinterested professionals. The Trustee contends that attorneys with conflicts of interest would be encouraged to go forward as counsel for a debtor, knowing that if their application for employment is denied by the bankruptcy court, they might still receive compensation under § 503.

In this court's view, permitting attorneys to receive a § 503 award in a narrowly-defined set of circumstances—such as that suggested by Judge Posner—would not have the dire consequences the Trustee predicts. The rule hypothesized by Judge Posner in Grabill would allow an attorney to recover under § 503 only where denying such an award would be "highly inequitable," and where the attorney: 1) filed his § 327 application as early as was practicable; 2) could not defer performing critical legal work for the debtor; 3) had no

reason to believe that his application would be turned down but it was, much later; and 4) provided services that conferred a benefit on the debtor's estate. Given these high standards, a professional who knowingly holds an adverse interest would take a huge risk by providing services to an estate in the hope of eventually receiving compensation under § 503. Bankruptcy judges, in the careful exercise of their discretion, would be more than capable of spotting such incidents. This court will adopt the rule articulated in Grabill.

The Trustee argues that even if Grabill is the law, MMK fails to satisfy two of the requirements set forth in that decision. First, the Trustee contends, there is no persuasive evidence that MMK performed critical legal services that could not be deferred. Second, MMK should have realized that its simultaneous representation of Milwaukee Engraving and Black Hawk could cause its application for employment to be turned down.

The court disagrees. The bankruptcy judge noted in her decision that Milwaukee Engraving's bankruptcy petition had been placed on a fast-track for confirmation. Deferring MMK's legal services in such a situation would have undoubtedly upset the schedule of the court's proceedings and affected the orderly restructuring of Milwaukee Engraving. The court concurs in Judge McGarity's statement that '[t]he services rendered by [MMK] quite likely could not have been deferred without compromising the case." (June 30, 1998 Mem. Dec. at 8.)

With regard to MMK's anticipation of the conflict, the court notes that MMK was representing Black Hawk in the sale of the company's assets—transactions that would presumably increase the likelihood of some repayment to Milwaukee Engraving. Given that fact, MMK could quite reasonably expect that its representation of the two entities would not present a conflict. MMK had apparently not

foreseen that its interest in collecting fees from Black Hawk might be adverse to Milwaukee Engraving's interest in obtaining the maximum repayment on Black Hawk's debt. Judge McGarity found that the disqualifying conflict in this case was "atypical." (Id.) Given the unusual nature of the adverse interest in this action, this court does not find that MMK should have had reason to expect that its application for employment might be rejected.[1]

B. Sufficiency of the Bankruptcy Court's Findings

The Trustee also contends that the bankruptcy judge's findings of fact were not sufficient to justify her conclusion that MMK should receive an award pursuant to § 503. An award is proper under § 503 if it both "(1) arise[s] from a transaction with the debtor-in-possession and (2) is beneficial to the debtor-in-possession in the operation of the business." In re: Jartran. Inc., 732 F.2d 584, 587 (7th Cir. 1984) (quoting In re Mammoth Mart. Inc., 536 F.2d 950, 954 1st Cir. 1976) (internal quotation marks. omitted). The Trustee asserts that MMX did not present any evidence or exhibits at the bankruptcy court's June 8, 1998 hearing and, thus, there is no evidence supporting that court's decision. In addition, the Trustee notes that the bankruptcy judge's opinion did not expressly apply the second element of a § 503 claim described above.

As the Trustee concedes, however, Judge McGarity had MMK's billing records before her, and her June 30, 1998 opinion expressly states that she reviewed those records in reaching her decision. From the descriptions of activities provided in those records, the bankruptcy judge concluded that MMK had performed services "critical to the successful reorganization of [Milwaukee Engraving]." (June 8, 1998 Mem. Dec. at 8.) The Trustee takes issue with the fact that Judge McGarity did not expressly state that MMK's services were beneficial to the operation of Milwaukee Engraving's

business. But it is clear to this court that for a business undergoing bankruptcy, retaining bankruptcy counsel is crucial to its successful operation. The court concludes that the bankruptcy court's decision was based on adequate findings of fact.

IV. CONCLUSION

The order of the bankruptcy court is **AFFIRMED.**

SO ORDERED this 25th day of August, 1999.

John W. Reynolds
United States
District Judge

Footnotes:

[1]The Trustee cites In re: Green Street, 132 B.R. 460 (Bankr. D. Utah 1991), as support for its position that MMK should have been aware that it might not be approved for employment. The court in Green Street held that "an attorney who represents a debtor and also represents a creditor or a debtor of that debtor represents an interest adverse to the estate.' at 462. In a very brief opinion, the Green Street court provided little reasoning for its decision. This court finds that the existence of the Green Street decision does not provide a sufficient basis for concluding that MMK should have recognized its adverse interest in this case.

11 USCS § 327 (2000)

§ 327. Employment of professional persons

(a) Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title [11 USCS §§ 101 et seq.].

11 USCS § 101 (2000)

§ 101. Definitions

In this title--

(14) "disinterested person" means person that--

(A) is not a creditor, an equity security holder, or an insider;

(B) is not and was not an investment banker for any outstanding security of the debtor;

(C) has not been, within three years before the date of the filing of the petition, an investment banker for a security of the debtor, or an attorney for such an investment banker in connection with the offer, sale, or issuance of a security of the debtor;

(D) is not and was not, within two years before the date of the filing of the petition, a director, officer, or employee of the debtor or of an investment banker specified in subparagraph (B) or (C) of this paragraph; and

(E) does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor or an investment banker specified in subparagraph (B) or (C) of this paragraph, or for any other

reason;

11 USCS § 503 (2000)

§ 503. Allowance of administrative expenses

(b) After notice and a hearing, there shall be allowed, administrative expenses, other than claims allowed under section 502(f) of this title, including—

(1) (A) the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case;

11 USCS § 329

§ 329. Debtor's transactions with attorneys

(a) Any attorney representing a debtor in a case under this title [11 USCS §§ 101 et seq.], or in connection with such a case, whether or not such attorney applies for compensation under this title [11 USCS §§ 101 et seq.], shall file with the court a statement of the compensation paid or agreed to be paid, if such payment or agreement was made after one year before the date of the filing of the petition, for services rendered or to be rendered in contemplation of or in connection with the case by such attorney, and the source of such compensation.

(b) If such compensation exceeds the reasonable value of any such services, the court may cancel any such agreement, or order the return of any such payment, to the extent excessive, to--

(1) the estate, if the property transferred--

(A) would have been property of the estate; or

(B) was to be paid by or on behalf of the debtor under a plan under chapter 11, 12, or 13 of this title; or

(2) the entity that made such payment.

11 USCS § 330 (2000)

§ 330. Compensation of officers

(a) (1) After notice to the parties in interest and the United States Trustee and a hearing, and subject to sections 326, 328, and 329, the court may award to a trustee, an examiner, a professional person employed under section 327 or 1103--

(A) reasonable compensation for actual, necessary services rendered by the trustee, examiner, professional person, or attorney and by any paraprofessional person employed by any such person; and

(B) reimbursement for actual, necessary expenses.

(2) The court may, on its own motion or on the motion of the United States Trustee, the United States Trustee for the District or Region, the trustee for the estate, or any other party in interest, award compensation that is less than the amount of compensation that is requested.

(3) (A) In determining the amount of reasonable compensation to be awarded, the court shall consider the nature, the extent, and the value of such services, taking into account all relevant factors, including--

(A) the time spent on such services;

(B) the rates charged for such services;

(C) whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case under this title [11 USCS §§ 101 et seq.];

(D) whether the services were performed within a reasonable amount of time commensurate with the complexity, importance, and nature of the problem, issue, or task addressed; and

(E) whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title [11 USCS §§ 101 et seq.].

(4) (A) Except as provided in subparagraph (B), the court shall not allow compensation for--

(i) unnecessary duplication of services; or

(ii) services that were not--

(I) reasonably likely to benefit the debtor's estate; or

(II) necessary to the administration of the case.

(B) In a chapter 12 or chapter 13 case in which the debtor is an individual, the court may allow reasonable compensation to the debtor's attorney for representing the interests of the debtor in connection with the bankruptcy case based on a consideration of the benefit and necessity of such services to the debtor and the other factors set forth in this section.

(5) The court shall reduce the amount of compensation awarded under this section by the amount of any interim compensation awarded under section 331, and, if the amount of such interim compensation exceeds the amount of compensation awarded under this section, may order the return of the excess to the estate.

(6) Any compensation awarded for the preparation of a fee application shall be based on the level and skill reasonably required to prepare the application.

(b) (1) There shall be paid from the filing fee in a case under chapter 7 of this title [11 USCS §§ 701 et seq.] $

45 to the trustee serving in such case, after such trustee's services are rendered.

(2) The Judicial Conference of the United States--

(A) shall prescribe additional fees of the same kind as prescribed under section 1914(b) of title 28; and

(B) may prescribe notice of appearance fees and fees charged against distributions in cases under this title [11 USCS §§ 101 et seq.]; to pay $ 15 to trustees serving in cases after such trustees' services are rendered. Beginning 1 year after the date of the enactment of the Bankruptcy Reform Act of 1994 [enacted Oct. 22, 1994], such $ 15 shall be paid in addition to the amount paid under paragraph (1).

(c) Unless the court orders otherwise, in a case under chapter 12 or 13 of this title, the compensation paid to the trustee serving in the case shall not be less than $ 5 per month from any distribution under the plan during the administration of the plan.

(d) In a case in which the United States trustee serves as trustee, the compensation of the trustee under this section shall be paid to the clerk of the bankruptcy court and deposited by the clerk into the United States Trustee System Fund established by section 589a of title 28.

(2)

Supreme Court, U.S.
FILED
DEC 2 2000

No. 00-595

In the Supreme Court of the United States

MAIER, MCILNAY & KERKMAN, LTD., PETITIONER

v.

IRA BODENSTEIN, UNITED STATES TRUSTEE

AND

MILWAUKE ENGRAVING COMPANY, INC.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENT IN OPPOSITION

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15 pp

QUESTION PRESENTED

Whether attorneys who are not "disinterested persons," under Section 327(a) of the Bankruptcy Code, are authorized to receive payment for fees and expenses under 11 U.S.C. 503(b)(1)(A).

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BRIEF FOR THE FEDERAL RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-8a) is reported at 219 F.3d 635. The opinion of the district court (Pet. App. 19a-30a) is unreported. The opinion of the bankruptcy court (Pet. App. 9a-18a) is reported at 230 B.R. 370.

JURISDICTION

The judgment of the court of appeals was entered on July 13, 2000. The petition for a writ of certiorari was filed on October 11, 2000. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Respondent Milwaukee Engraving Company filed an application with the bankruptcy court to employ petitioner Maier, McIlnay & Kerkman, Ltd., as general counsel for its Chapter 11 bankruptcy estate, pursuant to 11 U.S.C. 327(a)[1] of the Bankruptcy Code. Pet. App. 2a. Section 327(a) requires Chapter 11 debtors-in-possession[2] to obtain a bankruptcy court's authorization to employ attorneys to assist them in the Chapter 11 case, and provides that a bankruptcy court will approve the employment of attorneys only if they are "disinterested persons" who hold no "interest adverse to the estate."[3]

An affidavit accompanying petitioner's application disclosed that petitioner represented Black Hawk Label Company, Inc., a company that owed $78,000 to Milwaukee Engraving, in connection with Black Hawk's sale of its assets to a third party. Pet. App. 10a. The proceeds from the sale of Black Hawk's assets

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[1] Section 327(a) states that, "[e]xcept as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title. [11 U.S.C. §§ 101 et seq.]" Pet. App. 31a.

[2] When a debtor corporation is permitted to retain control of its property during a Chapter 11 reorganization, rather than having to turn its property over to a trustee, the corporation is referred to as a "debtor-in-possession." See 11 U.S.C. 1101(1).

[3] A "disinterested person" is defined under 11 U.S.C. 101 (14)(E) as a person that "does not have an interest materially adverse to the interest of the estate or any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor * * * or for any other reason[.]" Pet. App. 31a-32a.

were to be used to pay Black Hawk's debt to Milwaukee Engraving, but only after petitioner had collected its fees in connection with the sale. *Id.* at 2a.

Respondent United States Trustee objected to the application, arguing that, because of its representation of Black Hawk, petitioner could not qualify as a "disinterested person" free from interests materially "adverse to the estate," and thus was not eligible to be employed pursuant to Section 327(a). Pet. App. 2a, 10a.

Although the "demands of its calendar" prevented it from ruling on the application before petitioner had begun its work on the case, the bankruptcy court denied the application, citing the adverse interest created by petitioner's representation of Black Hawk in connection with the sale of the company's assets. Pet. App. 2a, 16a. Petitioner did not appeal the denial. *Id.* at 11a.

2. Petitioner subsequently filed an application for approximately $15,000 in fees and costs it incurred in this case. Pet. App. 2a. Petitioner argued that, even though the bankruptcy court's denial of the employment application rendered it ineligible to be compensated pursuant to 11 U.S.C. 330,[4] it could be awarded all of its fees and costs pursuant to 11 U.S.C. 503(b)(1)(A).[5]

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[4] Section 330(a)(1) authorizes bankruptcy courts to award "reasonable compensation" and reimbursement of expenses to attorneys employed under Section 327. Specifically, it states that, "[a]fter notice to the parties in interest and the United States Trustee and a hearing, and subject to sections 326, 328, and 329, the court may award * * * a professional person employed under sections 327 or 1103 [providing for employment of agents to represent creditors' committees] * * * reasonable compensation for actual, necessary services." 11 U.S.C. 330(a)(1)(A).

[5] Section 503(b) of the Code authorizes bankruptcy courts to allow certain claims for "administrative expenses." Such claims

Pet. App. 12a. This provision authorizes bankruptcy courts to allow those administrative expenses that are necessary to preserve the bankruptcy estate, including "commissions for services rendered after the commencement of the case." The United States Trustee opposed the request, noting that the court of appeals' decision in *In re Singson*, 41 F.3d 316 (7th Cir. 1994), established that courts have no authority under Section 503 to award attorney's fees that have not been approved under any other section of the Code. Pet. App. 12a.

The bankruptcy court awarded petitioner the required fees and costs pursuant to Section 503(b)(1)(A). The bankruptcy court reasoned that "[n]othing in the plain language of [Section] 503(b)(1)(A) would appear to preclude" it from granting the application, and that petitioner's application satisfied conditions that dicta in *In re Grabill Corp.*, 983 F.2d 773 (7th Cir. 1993), suggested might be appropriate.[6] Pet. App. 12a-16a. Because petitioner had promptly filed its application for employment and the delay in denial was based on the

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have first priority in distribution (11 U.S.C. 507(a)(1)). Subsection 503(b)(1)(A) identifies administrative expenses as including "the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case." Pet. App. 32a. Subsection (b)(2) authorizes courts to allow, as administrative expenses, compensation and reimbursement awarded under Section 330(a). 11 U.S.C. 503(b)(2).

[6] In *Grabill*, the court of appeals suggested (983 F.2d at 777) that Section 503(b)(1)(A) might be used to "relieve the rigidity of section 330" in circumstances where a lawyer has filed his application for employment as early as practicable, could not defer performing critical legal work for the debtor, had no reason to believe that his application would be turned down, and had performed transactions of benefit to the debtor-in-possession.

demands of the court's calendar, the bankruptcy court concluded that it would be inequitable to disallow petitioner's expenses. *Id.* at 16a. Thus, the bankruptcy court's decision to award attorney's fees under Section 503(b)(1)(A) was principally grounded in equity.

The United States Trustee appealed to the district court, and the district court affirmed, adopting the bankruptcy court's reasoning. Pet. App. 24a-28a. The United States Trustee then filed an appeal to the Seventh Circuit.

3. The court of appeals reversed. Reasoning that *Singson* constituted controlling authority, the court of appeals explained, "*Singson* concluded that it would vitiate the limitations of [Section] 327 if a bankruptcy court could deny an application under that section and order the estate to pay for the legal services anyway." Pet. App. 4a. The court of appeals reasoned that, "the structure of [Section] 503(b) strongly implies that professionals eligible for compensation must receive it under [Section] 503(b)(2)—which depends on authorization under [Section] 330 or [Section] 1103(a)(and thus on approval under [Section] 327)." *Ibid.* The court of appeals observed that, "[o]ne might as well erase [Section] 503(b)(2) from the statute if attorneys may stake their claims under [Section] 503(b)(1)(A) even when ineligible under [Sections] 327, 330 and 503(b)(2)." *Ibid.*

Accordingly, the court of appeals held that *Singson* conclusively answered the question at issue: "may a bankruptcy court compensate an attorney for services despite denying an application under [Section] 327?"—with an unqualified "no." Pet. App. 4a. The court also noted that its decision in *Singson* was consistent with that of every other appellate court that had considered the matter. *Id.* at 8a.

ARGUMENT

The court of appeals' decision is correct and does not conflict with any decision of this Court or any other court of appeals. Further review is not warranted.

1. The court of appeals correctly relied on the structure of Section 503(b) to conclude that "professionals eligible for compensation must receive it under [Section] 503(b)(2)—which depends on authorization under [Section] 330 or 1103(a)—(and thus on approval under [Section] 327)." Pet. App. 4a. Sections 327 and 330 subject the employment and compensation of attorneys to exacting prophylactic measures designed to protect the interests of all interested parties. See *In re Crivello*, 134 F.3d 831, 835-836 (7th Cir. 1998). Under Section 327, a bankruptcy court may employ attorneys to represent a bankrupt estate only if they do not hold or represent an interest adverse to the estate, and are "disinterested persons." 11 U.S.C. 327. Section 330(a)(1)(A) authorizes courts to award "reasonable compensation" and reimbursement of expenses to attorneys "employed under section 327." 11 U.S.C. 330(a)(1)(A). Section 503(b)(2) authorizes courts to allow, as administrative expenses, compensation and reimbursement awarded under Section 330(a). 11 U.S.C. 503(b)(2).

Construing these statutes together, the court of appeals correctly concluded that petitioner was not entitled to compensation under Section 503(b)(1)(A) because compensation for attorneys was governed by Section 503(b)(2). Pet. App. 4a. Since petitioner's application for employment was rejected pursuant to Section 327, by the terms of these provisions, compensation for fees and costs could not be awarded under Section 330(a) or 503(b)(2).

Petitioner contends that Section 503(b)(1)(A) of the Code permits courts to authorize payment of attorney's fees, even when an employment application has been denied under Section 330(a) of the Code. Pet. 15. The court of appeals correctly rejected that argument. The Code's plain language specifies that attorney's fees are to be awarded by a court pursuant to a stringent set of guidelines and constraints set out in Sections 327-330. Section 503(b)(1)(A) by its terms does not expand those limitations, since it does not authorize courts to "award" attorney's fees; it simply permits the allowance of certain administrative expenses. Nor may this omission reasonably be considered an oversight, in light of the fact that the very next subsection of Section 503(b) specifically authorizes the "allowance" of attorney's fees that *have* been "awarded" pursuant to Section 330(a). 11 U.S.C. 503(b)(2). "[T]he cardinal rule to construe provisions in context" (*United States* v. *Balsys*, 524 U.S. 666, 673 (1998)) prohibits reading the term "allow[]" in Section 503(b)(1) as including the meaning "award," because the next subsection of the statute treats the "award" and the "allowance" of fees as separate, cumulative requirements. Cf. *Crivello*, 134 F.3d at 837 ("[a] reviewing court may not insert additional language into the Code to conform it with the court's view of bankruptcy law").

Petitioner's contrary reading of Section 503(b)(1)(A) also contravenes at least two other bedrock principles of statutory construction. First, it permits a general provision (Section 503(b)(1)(A)) to govern the provision (Section 503(b)(2)) dealing specifically with the allowance of attorney's fees, contrary to the principle that "it is a commonplace of statutory construction that the specific governs the general." *Morales* v. *TWA*, 504 U.S. 374, 384 (1992). Second, it renders ineffective the

array of provisions specifically authorizing—and constraining—the courts' authority to award attorney's fees, contrary to the principle that "[courts should be] reluctant to adopt a construction making another statutory provision superfluous." *Hohn* v. *United States*, 524 U.S. 236, 249 (1998); accord *Crivello*, 134 F.3d at 839 (preferring an interpretation that "gives full effect" to both of the two relevant Code provisions). As the court of appeals correctly observed, "[o]ne might as well erase [Section] 503(b)(2) from the statute if attorneys may stake their claims under [Section] 503(b)(1)(A) even when ineligible under [Sections] 327, 330 and 503(b)(2)." Pet. App. 4a.

Finally, the court of appeals correctly ruled that Section 503(b)(1)(A) could not be used, in equity, to "defeat the principal function of [Section] 327 by requiring the estate to compensate a law firm that labored under a conflict of interest." Pet. App. 5a. Thus, the court of appeals properly reversed the decisions of the bankruptcy and district courts, finding that their attempt to avoid the plain language of Sections 327, 330 and 503(b)(2) violated the principle enunciated by this Court in *Raleigh* v. *Illinois Dep't of Revenue*, 120 S. Ct. 1951, 1957 (2000), that "[b]ankruptcy courts are not authorized in the name of equity to make wholesale substitution of underlying law * * * but are limited to what the Bankruptcy Code itself provides." Pet. App. 4a-5a.

2. In recognizing these principles, and rejecting the use of Section 503 to award attorney's fees that have not been authorized pursuant to any other provision of the Code, the court of appeals' ruling here is fully consistent with that of every other court of appeals that has addressed the issue. See *In re Keren Ltd. P'ship*, 189 F.3d 86, 88 (2d Cir. 1999) (per curiam) ("[i]t is plain

from the Code that compensation for professional services will only be an administrative expense when approved by the court") (affirming the lower courts' denial of a professional's application for compensation pursuant to Section 503(b)(1)(A) because the services were not authorized under Sections 327 and 330); *In re F/S Airlease II, Inc.*, 844 F.2d 99, 108-109 (3d Cir. 1988)("The authority to pay administrative expenses for professionals * * * is found not in section 503(b)(1)(A) but in section 503(b)(2) * * * . If [the professional] were able to be compensated under section 503(b)(1)(A), it would render section 327(a) nugatory and would contravene Congress' intent in providing for prior approval") (cited in *Singson*, 41 F.3d at 320); *In re Monument Auto Detail, Inc.*, 226 B.R. 219 (B.A.P. 9th Cir. 1998); *In re Albrecht*, 245 B.R. 666 (B.A.P. 10th Cir. 2000), aff'd, No. 00-8022 (10th Cir. Dec. 4, 2000); see also 6 *Collier on Bankruptcy* § 943.03[3][b][i] (Lawrence P. King ed., 15th ed. rev. 2000) ("section 503(b)(1) can hardly be a basis for imposing administrative liability for professional compensation[—i]f section 503(b)(1) was a sufficient statutory basis for allowing such claims, sections 328-331 would be rendered superfluous").

Contrary to petitioner's argument (Pet. 5-10), the court of appeals' decision does not conflict with *In re Federated Dep't Stores, Inc.*, 44 F.3d 1310 (6th Cir. 1995). In *Federated Department Stores*, the debtor corporation asked the bankruptcy court for permission to hire Lehman Brothers as a financial advisor to aid it in developing a reorganization plan. The Trustee objected, arguing that Lehman Brothers was not a "disinterested person" as defined under Section 327(a) of the Code. *Id.* at 1313. However, the bankruptcy court rejected this argument, holding that equitable prin-

ciples and the need for a quick and effective reorganization warranted departure from the strict language of the statute. *Ibid.* Although the Trustee appealed the decision to the district court, that court waited three years before issuing a ruling. By that time, the reorganization was complete, and Lehman Brothers had received interim compensation pursuant to the bankruptcy court's order. *Id.* at 1314. During the pendency of the appeal, the Sixth Circuit decided *In re Middleton Arms, Ltd. Partnership*, 934 F.2d 723 (1991). There, the court of appeals affirmed the district court's holding that equitable principles could not override the plain and unambiguous language of Section 327(a). *Id.* at 725. When it finally took up the issue, the district court in *Federated Department Stores* distinguished *Middleton Arms*, holding that the decision to award fees was within the bankruptcy court's discretion. 44 F.3d at 1315. It therefore granted Lehman Brothers' final request for compensation and reimbursement, over the Trustee's objections.

The Sixth Circuit reversed, ruling that *Middleton Arms* prevented the award of compensation to Lehman Brothers when it was not a disinterested party under Section 327(a) and that the court's equitable powers could not be used to contravene the plain and unambiguous language of the statute. 44 F.3d at 1319. Lehman Brothers was thus ordered to return any proceeds received after June 6, 1991, the date on which *Middleton Arms* was decided. The court of appeals reasoned that prior to this date, the issue had not been definitively decided in the Circuit, but that after the decision in *Middleton Arms* was rendered, Lehman Brothers was on notice that it was not a valid or legitimate financial advisor. *Id.* at 1320. This was an equitable remedy, expressly limited to the unique facts

of that case, where Lehman Brothers was being ordered to return fees that had already been distributed. *Ibid.*

Federated Department Stores can thus be distinguished on the grounds that Section 503(b)(1)(A) was not the basis on which an equitable remedy was fashioned, and that the remedy reached was expressly limited to the unique facts of that case. Further, *Federated Department Stores* is consistent with the holding reached by the court of appeals here, to the extent that it reaffirms the general principle that equity cannot be invoked to contravene the plain and unambiguous requirements of Sections 327(a) and 330(a). 44 F.3d at 1319-1320.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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